Appendix 1

Epping Forest District Council

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Report of the Affordable Housing Sub-Group to the Housing Scrutiny Panel

Ways to Increase the Amount of Affordable Housing within the District and the Possibility of the Council Re-commencing a Social House-Building Programme

Epping Forest District Council
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1. Introduction

1.1 At its meeting in July 2009, the Housing Scrutiny Panel agreed to set up an Affordable Housing Sub-Group to consider ways of increasing the amount of affordable housing provided in the District. This followed a suggestion by Cllr Mrs R. Brookes. She commented at our first meeting that, apart from ward constituency business, housing was the issue that had made the biggest impression on her since joining the Council. She was particularly struck by the information provided at the Housing Strategy Conference during the year and, in particular, the fact that average property prices in the District are around 11 times the average earnings for the District. She had also noted the high number of expressions of interest made by housing applicants for vacant properties, through the Home Options Choice Based Letting Scheme. She had wondered whether, at this time of low interest rates, more affordable housing - in the form of social rented housing and intermediate housing - could be provided by the Council.

1.2 The Housing Scrutiny Panel had appointed the members of the Sub Group, as follows:

Councillor Mrs R Brookes
Councillor Mrs A Grigg
Councillor Mrs J Lea
Councillor S Murray

1.3 We had our first (and only) meeting on the 26th November 2009. Unfortunately, Cllr K Chana was unable to attend. We appointed Cllr Mrs R. Brookes as our Chairman. The Director of Housing, Alan Hall, and the Assistant Director of Finance (Accountancy), Peter Maddock, were in attendance to advise the Sub Group. We were also pleased that Councillor D Stallan, the Housing Portfolio Holder, attended our meeting, and took part in the discussions.

1.4 We had the benefit of two detailed reports from the Director of Housing to consider. The first report set out the assessed need for affordable housing; the past, current and future provision; and identified some ways in which the Council could increase the amount of affordable housing within the District. The second report considered the possibility and implications of the Council re-commencing a modest Social House-Building Programme, following a relaxation of the financial regulations by the Government that previously inhibited such activity.

2. Increasing the Provision of Affordable Housing

Regional Spatial Strategy - The East of England Plan

2.1 The Regional Spatial Strategy for the East of England has currently planned for the provision of 48,600 additional dwellings in the Region by 2021, including 3,500 dwellings in Epping Forest (an annual rate of 175 per annum), plus a requirement for the Epping Forest District to contribute towards the expansion of Harlow by making provision for an additional, currently unspecified, number of homes close to Harlow.

2.2 Of the required 3,500 additional homes within the District, 1,784 additional homes were built between April 2001 and April 2009, which count towards this target. Furthermore, by April 2009, outline planning permissions had already been granted for 565 additional homes and detailed planning permission granted for a further 790 homes to be built. Therefore, the minimum amount still to be provided in the Epping Forest District (through new planning permissions) between 2009 and 2021 (excluding those homes required to contribute towards the expansion of Harlow) is just 361 – an annual rate of around just 30 homes per annum, comprising both market housing and affordable housing.

2.3 Assuming that all 361 additional homes are on large sites, of which 40% would be provided as affordable housing, the East of England Plan only requires the Council to identify land to provide just 145 affordable homes between April 2009 and 2021 (in addition to the number of affordable homes to be provided from the total homes to be provided in the Epping Forest District around Harlow, to meet the growth requirements of that town).

Need for Affordable Housing

2.4 For some years, Government guidance on housing and planning has emphasised the requirement for local authorities to assess local housing need and develop strategies to address that need. This assessment process has generally been achieved by conducting Housing Needs Surveys. The Council last undertook a District-wide Housing Needs Survey in 2003, covering the period from 2003 to 2008.

2.5 However, in 2006, a national framework was introduced under Planning Policy Statement 3 (PPS3) for carrying out Strategic Housing Market Assessments (SHMAs), with final guidance published in March 2007. These assessments continue to provide information on the level of need and demand for housing locally, but they also contribute to the sub-regional and regional levels of planning.

2.6 A Strategic Housing Market Assessment (SHMA) analyses the entire local housing market, which is normally wider than local authority boundaries. It forms a crucial part of the evidence base that informs planning policies. The Council is within the Eastern Region for planning purposes, and part of the London Commuter Belt (LCB) Sub Region for housing purposes. Since the LCB Sub Region comprises 15 local authorities, it was considered too large an area for the production of a detailed and meaningful study. Therefore, 6 districts of the Sub Region, including Epping Forest, joined to form the London Commuter Belt (East)/M11 SHMA Area and commissioned Opinion Research Services (ORS) and Savills to undertake a comprehensive and integrated SHMA. The other 5 districts in the SHMA area are Brentwood, Broxbourne, East Herts, Harlow and Uttlesford. The research used secondary data from sources such as the UK Census, the former Housing Corporation, HM Land Registry and the Office for National Statistics, along with a consultation programme with a wide range of stakeholders.

2.7 We were advised that the SHMA found that an estimated 7,100 households in Epping Forest are considered to be unsuitably housed. The term ‘unsuitably housed’ is used to encompass households:

- that are homeless or have insecure tenure;
- that are ‘mismatched’ to the dwelling they live in;
- living in dwellings that lack amenities or are in a poor condition; and
- with social needs that can only be resolved through a move.

2.8 Some unsuitably-housed households may choose to move elsewhere, but not all problems of unsuitable housing require a move from the householder’s current home. For example, a problem may be resolved by extending or repairing the home, or - where overcrowding exists - one or more member(s) of the household may be able to move out of the property. Where such solutions could not be applied, due to affordability or other reasons, a household is considered to be in ‘housing need’ (a much rarer event than being unsuitably housed).

2.9 According to Land Registry data, the average (mean) property price in Epping Forest in 2008 (Quarter 4) was around £340,000. The average property price rose by 133 % between 2000 and 2008 (Quarter 1) - the highest increase in the SHMA Area.

2.10 In 2002, the average property price in Epping Forest was 9 times the median full-time earnings of someone working in the District. This rose to 11 times the median earnings by 2007 (compared to 6.5 times earnings in Harlow) – which is, by far, the highest ratio in the SHMA Area, although the largest increase in ratio was in Brentwood.

2.11 In determining mortgage borrowing, the Government states that it should be assumed that a single earner will borrow up to 3.5 times his/her earnings, with two-income households borrowing no more than 2.9 times their joint income. On this basis, the SHMA report identified that virtually no owner-occupied housing is affordable to households earning less than £30,000 per annum, and only 12 % of properties sold in the area would be affordable to individual earners with incomes of less than £50,000, borrowing at the maximum 3.5 times ratio, assuming little or no equity. For households to be able to consider the cheapest 25% of properties on the market in the SHMA Area, individual earners would need to earn at least £55,000 - £60,000, with joint-borrowers needing incomes of £65,000 - £70,000 or more. This equates to a property price of nearly £200,000, which is well below the average property price in Epping Forest.

2.12 For households earning £20,000 or less (typically assumed to require social rented housing) in the SHMA Area, just 17 % of local housing would be affordable – almost entirely in the social housing sector (with or without benefit support).

2.13 Around 50% of the stock in the SHMA Area requires earnings of over £65,000, with around a third requiring annual incomes of more than £80,000 per annum. Since over 75% of the stock is owner-occupied, many households will have existing equity and will not depend exclusively on the household income. However, most newly-forming households (and households moving out of rented housing) do not benefit from this additional finance.

2.14 In conclusion, we were advised that the SHMA Report identified that, based on long-term trends, there is an overall housing requirement by 2026 of 50,100 properties in the SHMA area, of which 47% (23,400) should be affordable housing.

2.15 The SHMA Report also identified that there is a residual requirement for 6,600 homes to be delivered in Epping Forest between 2007 and 2026, including an assumed provision of an additional 3,000 new homes in the District for the growth of Harlow. Bearing in mind this shortfall, the SHMA breaks down the projected residual housing requirement from the East of England Plan into the “ideal” amounts required for different tenure types.

2.16 Because house prices in 2007-8 were 21.5% above the long-term house price trend, the projections for the housing mix are based on a reduction of 21.5% from the 2007/8 level, to take account of the long-term house price trends.

Housing Requirement	Based on Long-Term Trends	
	Epping Forest	Harlow & M11 Corridor
Market housing	2,000 (30 %)	27,200 (54 %)
Intermediate affordable housing	1,800 (26 %)	12,100 (24 %)
Social rented housing	2,900 (44 %)	10,800 (22 %)
Total Housing Requirement	6,600	50,100

2.17 We noted that Epping Forest has the highest predicted percentage requirement of the total allocation for affordable housing, compared to the other local authorities, in the SHMA Area. The lowest is Harlow (11.5%).

2.18 However, we noted that the Council’s recently completed Housing Strategy 2009-2012 recognised that it is unrealistic to expect that only 30% of the required 6,600 new homes provided in the District will be in the form of market housing, since the provision of most new housing is brought forward by developers, for whom it would be uneconomic to provide such a low level of market housing. Since it is unlikely, both for commercial and economic viability reasons, that the amount of affordable housing required of developers on development sites will be increased from the current requirement of 40%, the following table – reproduced from the Council's Housing Strategy provides a more realistic breakdown:

Epping Forest ("Realistic")	Housing Requirement 2007-26
Market housing	3,960 (60 %)
Intermediate affordable housing	925 (14 %)
Social rented housing	1,715 (26 %)
Total Housing Requirement	6,600

2.19 Since this will provide just 2,640 new affordable homes - an annual rate of around 132 per annum - it will leave a projected shortfall of around 2,060 affordable homes in the Epping Forest District, compared to the need for 4,700 affordable homes assessed by the SHMA, based on long-term house price trends.

Ability to Provide Affordable Housing

2.20 We noted that the Council's ability to increase the amount of affordable housing in the District is constrained by three main issues:

Land

2.21 We were made aware that the Council has not yet produced either its Core Strategy or its Site Specific Allocations under the Local Development Framework. The latter document will set out the locations where additional housing in the District will be allowed to meet the requirements of the East of England Plan.

2.22 Moreover, prior to the adoption of the East of England Plan, we were advised that the Council exceeded the previous Essex and Southend-on-Sea Structure Plan targets for new house-building, 8 years ahead of schedule; so all allocated sites were developed a number of years ago. Therefore, for a number of years, all new developments (including associated affordable housing) have been on unplanned "windfall" sites. This will not change until the Council allocates additional land through its Site Specific Allocations.

2.23 We noted that the current position is that, following the issue of a "Call for Sites" inviting landowners to submit proposals for land to be included within the Site Specific Allocations, the submissions are currently being assessed by planning officers and will then be considered by the Local Development Framework Task and Finish Panel.

Grant

2.24 Although affordable housing can be provided without grant from the Homes and Communities Agency (HCA – one of the successors to the former Housing Corporation) or the Council, we were advised that the amount of affordable housing (compared to the percentage of market housing on Section 106 sites) is significantly reduced without grant. In any event, land is still needed.

Members' Priorities

2.25 We acknowledged that the Council is responsible for delivering many different – often conflicting - policies and services, and must balance these priorities. We recognised that, although more affordable housing could be provided in the future, it could have to be at the expense of other Council priorities.

Housing Register

2.26 We were advised that there are currently around 4,740 housing applicants registered on the Council's Housing Register in need of affordable housing. We were concerned to note that this number had increased by an incredible 20% over a four month period during 2009, and by over 30% over the past 18 months. This can be compared with just 1,480 households registered on the Housing Register in March 2002. We recognised that the main reasons for the significant increase are due to the recent collapse in the property market and the effects of the "credit crunch" and the recession on residents within the District.

Recent Affordable Housing Completions

2.27 Due to the dearth of housing sites in recent years, resulting from the early achievement of the previous Structure Plan target, we were advised that there have been very low numbers of affordable homes provided in past years. However, we noted that the number of expected completions this year is more significant, as shown below:

Tenure	2009/10 (Forecast)	2008/9	2007/8	2006/7
Rented (exc. special needs)	77	9	4	14
Shared Ownership	30	25	10	5
Totals	107	34	14	19

2.28 We were advised that the expected completions in 2009/10 are for the following developments (some of which have already been completed):

Development	No. of Affordable Homes
Epping Forest College, Loughton	56
St. Margarets Hospital, Epping	40
Spencer House re-provision	2
Pyrles Lane, Loughton	9
Totals	107

Affordable Housing Pipeline

2.29 We were advised that, in addition, a further 10 developments have either detailed or outline planning permission and are either on-site or have not yet started. It is expected, subject to the effect of the economic climate, that all these developments will be completed by March 2011 and will provide an additional 356 affordable homes, as follows:

Site	No. of Affordable Homes	Status (as at 1.11.09)
Epping Forest College (Phase 2), Loughton	39	On Site
White Lodge/The Limes, W/Abbey	96	Not yet started
Ongar Station, Ongar	19	Not yet started
Merlin Way, North Weald	80	Not yet started
Jennikings Nursery, Chigwell	54	Not yet started
St. Johns School, Epping	38	Not yet started
Church Hill, Loughton	4	To be tendered by EFDC
Acres Avenue, Ongar	12	Not yet started
Theatre Resource, Ongar	9	Not yet started
School Lane, Abbess Roding (Rural)	6	Not yet started
Off site provision from Warren Hill development, Loughton	5	Not yet acquired
Totals	362	

2.30 In addition, we noted that active consideration is currently being given by developers for the development of a further 7 sites in the District. Although unlikely, based on the developers' current proposals, we were advised that if all 7 developments receive planning permission, it would result – as at 1st November 2009 - in the provision of a further 172 affordable homes.

The Council's Capital Strategy

2.31 Each year the Council produces a Capital Strategy, which is a "high level" strategic document, linked to the Council's other key strategic documents. This follows the annual re-assessment of the Council's Key Capital Priorities, which set out the main areas in which the Council will invest its capital resources. These Key Capital Priorities are ranked, so that capital resources can be targeted at those ranked highest.

2.32 We noted that there are 8 Key Capital Priorities set out in the latest Capital Strategy, of which one is "Meeting Housing Need". Last year, this Key Capital Priority was ranked as the 2nd Highest Priority. However, at the Cabinet meeting on 16th November 2009, the Capital Strategy for 2009-2010 was approved, and it was agreed to raise the ranking of "Meeting Housing Need" to the *Highest* Priority, replacing the Key Capital Priority of "Improving the Council's Housing Stock", which is now the Council's 2nd Highest Key Capital Priority (having been the Highest one for last few years).

2.33 However, despite this ranking, we noted that, of the £53m being spent by the Council on capital projects over the five-year period 2009/10 - 2013/14, only £554,000 (1%) has been allocated to fund new affordable housing initiatives to help meet housing need.

Capital Funding Availability

2.34 Notwithstanding the low amount of capital resources currently allocated to fund affordable housing initiatives, we were advised that there is limited scope within the Capital Programme to divert funding from other projects. Therefore, if any additional funding is made available for new affordable housing initiatives to help meet housing need, it would be necessary to increase the Council's Capital Programme, funded from capital receipts.

2.35 We noted that it is currently predicted that the balance of usable capital receipts will fall from around £19.24m in April 2010 to around £11.03m in April 2014 (after taking into account capital projects needing capital funding over this period). We also noted that the Council is currently benefiting from the revenue income generated by the investment of these balances. The full year effect of funding, say, £1m of additional expenditure from capital receipts would be to reduce investment income by approximately £10,000 per annum at current interest rates. Any additional expenditure would therefore have an impact on either the level of the Council Tax or the level of other services being provided.

Ways of Increasing the Amount of Affordable Housing

2.36 Following consideration of the background outlined above, we then considered a detailed report from the Director of Housing on possible ways the Council could modestly increase the amount of affordable housing within the District.

Open Market Shared Ownership

2.37 We noted that the Cabinet has made provision of £350,000 within the Capital Programme for one of the Council's Preferred RSL Partners (Moat) to operate a bespoke low cost home ownership scheme for Epping Forest, called Open Market Shared Ownership. Under the proposed scheme, housing applicants would be able to purchase a one-bedroomed property on the open market on a shared ownership basis ("part rent – part buy").

2.38 The benefit of this approach would be that, firstly, it does not rely on new developments coming forward by developers on Section 106 sites and, secondly, it would provide much greater flexibility to applicants than "NewBuild" shared ownership, since instead of being restricted to new-build opportunities that may arise on a specific new development in a specific location, applicants could choose the home they wish to purchase within a prescribed maximum purchase price.

2.39 We were advised that, under the scheme already agreed by the Cabinet, applicants would purchase a 50% equity share in a one-bedroomed flat that they select on the open market, which would be funded by the applicant through a mortgage and any deposit. The Council and Moat would purchase two remaining shares, totalling the remaining 50%. Based on the purchase of a flat valued at £190,000, Moat's share would be 21% and the Council's would be 29 %. The applicant would pay Moat an annual rent, initially equivalent to 2.5% per annum of the value of the equity held by both Moat and the Council, which Moat would use to fund the cost of the loan required to purchase its share. The amount of equity that Moat could purchase would be directly dependent on the rental income received; the Council would then purchase the remaining equity. No rent would be payable to the Council for its equity share.

2.40 We noted that, under the proposed scheme, the shared-owner would be able to purchase additional tranches of equity from Moat and the Council, up to the full 100% equity (referred to as "staircasing"). The price for the tranches would be linked to the open market value of the property at the time of purchase. The proceeds from each tranche purchase would be split between Moat and the Council, according to the respective percentage equity holdings. Therefore, over time, the Council would recoup its initial investment, plus the increased value of its equity (provided property prices increase). It was proposed that the capital receipts received by the Council as a result of staircasing would be held by the Council and used to fund further purchases in the future, in the same way. Similarly, any net receipts received by Moat from staircasing (after repaying its loan to purchase the initial equity) would be kept by Moat in an interest-bearing account, ring-fenced, and used to supplement further equity purchases by the Council (or, at the discretion of the Council, to fund other affordable housing schemes).

2.41 However we noted that, soon after the Cabinet had agreed the bespoke scheme, the Government introduced a very similar new national scheme (through the Homes and Communities Agency - HCA), called "MyChoice Homebuy", which was more generous to applicants. Therefore, we noted that, in April 2008, the Housing Portfolio Holder decided that the Open Market Shared Ownership Scheme should be held in abeyance, and that no further work should be undertaken, until the demand and success of the new MyChoice HomeBuy Scheme could be assessed. However, we also noted that he had decided that the budget provision for the Scheme should be retained in the Capital Programme, and that a decision on whether or not to implement the scheme - and continue to make budget provision within the Capital Programme – should be made at a later date.

2.42 We were advised that, in Autumn 2009, the Government closed the MyChoice Homebuy Scheme. This was because the Government wanted to shift the resources allocated to MyChoice Homebuy, to new-build affordable housing, to assist with the credit crunch and the stalled house-building industry.

2.43 We were interested to note that MyChoice Homebuy had proved to be a very popular, flexible, scheme to assist first time buyers and that the Director of Housing had therefore made contact with Moat to ascertain whether or not they would be interested in either introducing the Open Market Home Ownership Scheme previously agreed in principle, or discussing an alternate scheme based on the MyChoice Homebuy model, but with the Council taking the place of the HCA.

2.44 However, we were advised by the Director of Housing that Moat Housing Group had said that it was no longer interested in working with the Council on such a scheme, because it was now targeting its efforts on providing shared ownership schemes through new-build. The Director of Housing explained that, in view of this, he had recently made contact with Orbit Housing Group, which is the Homebuy Agent for another part of the Country, to ask if, in principle, Orbit would be interested in working with the Council on either;

(a) The Open Market Shared Ownership Scheme already agreed by the Cabinet; or

(b) An alternate scheme, similar to Moat's successful MyChoice Homebuy Scheme, but with the Council undertaking the role of the Homes and Communities Agency

2.45 However, subsequently, at the meeting of the Housing Scrutiny Panel in December 2009, the Director of Housing advised that Orbit had also declined the offer to work in partnership with the Council on this initiative. Therefore, the Director of Housing has approached Aldwyk Housing Association, the Homebuy Agent for Hertfordshire, to enquire of their interest. A response is currently awaited.

2.46 Subject to the outcome of the discussions with Moat Housing, it is likely that the £350,000 budget could fund the purchase of around 6 properties under the Open Market Shared Ownership Scheme, or around 5 properties under an alternate MyChoiceHomebuy Scheme. It should be noted, however, that this investment would not just fund one purchase since, when the applicant purchases additional tranches of equity - or sells their property – the Council would receive a capital receipt, which could be used to assist further applicants. Ultimately, the Council would recover its investment – which would be either more or less than its original investment, depending on whether the value of the properties purchased with the grant has increased or decreased in value.

2.47 After discussion, we concluded that we should recommend that the budget provision of £350,000 should be retained within the Capital Programme, but that no increase in the budget should be sought at this stage, in view of the current uncertainty of a provider.

Home Ownership Grants

2.48 We recalled that, in October 2007, the Cabinet approved a pilot scheme for the provision of five Home Ownership Grants of £34,000 each, totalling £170,000, to be awarded to five Council tenants in 2008/9 (subject to them meeting an agreed criteria). The grants enabled secure tenants to purchase a property on the open market and give vacant possession of their Council property on the day of completion. Once their property was vacated, the Council then made this vacancy available through the HomeOptions Choice Based Lettings Scheme. The Scheme therefore assisted five tenants to enter home ownership, and a further five housing applicants to access Council housing. We noted that the Cabinet also agreed that the Housing Portfolio Holder should review the Pilot Scheme after six month's operation, including whether the funding allocation was sufficient.

2.49 We were advised that, due to the successful promotion of the Scheme, 38 applications were received and that the Housing Portfolio Holder had therefore subsequently agreed a selection criteria to allocate the five grants; all five applicants completed their house purchase.

2.50 We further noted that, in March 2009, the Cabinet had reviewed the success of the scheme and, in view of the economic climate and the difficulties for first-time buyers to secure mortgages to purchase properties on the open market, had agreed to make capital provision of a further £170,000 in 2009/10, to fund a further five Home Ownership Grants.

2.51 We noted that the Scheme continues to be popular and successful and that, following a marketing exercise earlier in the year, 31 tenants had applied for Home Ownership Grants. Five had been shortlisted, who are currently in the process of finding homes on the open market.

2.52 There is currently no budget provision within the Housing Capital Programme to fund any further grants. However, at the Cabinet meeting in March 2009, it was agreed that the Housing Portfolio Holder should review the success of the Scheme's continuation after nine month's operation and reports to the Cabinet on whether or not the Scheme and associated funding should be continued into 2010/11.

2.53 We therefore considered whether or not we should recommend the continuation of the Scheme in 2010/11. We concluded that the Scheme should continue, since it assisted both first time buyers and applicants on the Council's Housing Register. However, in view of the relatively high interest shown in the grants by tenants, we felt that there may be benefits in reducing the individual amount of grant from £34,000 to £28,000, which would enable 6 grants to be provided within the budget of £170,000, instead of 5 grants.

2.54 The Assistant Director of Finance and ICT (Accountancy) explained that the Cabinet undertakes a full review of the Capital Programme in the Autumn each year. However, he further explained that the Capital Programme could be updated at any time during the year, and we therefore agreed to recommend that budget provision of £170,000 be made for the provision of 6 Home Ownership Grants in 2010/11.

2.55 We also decided to recommend that, in the first instance, all those unsuccessful applicants for the Home Ownership Grant Scheme this year should be contacted, to see if they are still interested in grants and, if so, that they should be selected in accordance with the established criteria. We felt that, only if there are insufficient numbers interested, should another marketing exercise be undertaken.

Development of Under-used Difficult-to-let Council Garage Sites

2.56 We were reminded by the Director of Housing that Estuary Housing Association had recently completed the development of six small developments on land previously owned by the Council - mainly on difficult-to-let garage in Loughton, Buckhurst Hill and Waltham Abbey - to provide homes for local people on the Council's Housing Register.

2.57 The six sites have provided 29 new homes – 18 homes are for rent, at affordable rents with long term assured tenancies and 11 homes are for shared ownership for first time buyers, enabling the occupiers to buy equity in their home, and to increase the amount of equity in future years, up to full home ownership.

2.58 We were advised that the Council had enabled the developments to be built, by providing a capital grant to Estuary Housing Association of £1 million and by transferring the land for free. The remainder of the costs were funded by Estuary's private finance (a loan from a funding institution). All residents for the rented housing were nominated by the Council, through the Council's HomeOptions Choice Based Lettings Scheme.

2.59 We noted that a further development by Estuary Housing Association - of 12 shared ownership homes for first time buyers at Acres Avenue, Ongar – is due to commence shortly, once the legal agreements have been finalised. This scheme is being funded by the Homes and Communities Agency.

2.60 The Council continues to have a number of difficult-to-let garage sites with: more than 20% of the garages vacant; many of the garages used for storage; and no applicants on the waiting list.

2.61 We were advised that, some time ago, seven difficult-to-let garage sites had been identified by the Director of Housing as potentially having development potential. The Cabinet had agreed that Home Housing should undertake an initial feasibility study to assess the potential number of affordable homes that could be provided on these sites, with a view to undertaking the development. This had established that, potentially, 40 new affordable homes could be provided on these sites, subject to the receipt of planning permission.

2.62 We understand that, more recently, a simple desk-top exercise has identified a further 43 difficult-to-let garage sites, that may also have development potential, and that site visits are currently being undertaken to these sites to ascertain whether or not they could be developed.

2.63 We agreed to support the principle of undertaking more detailed feasibility studies of these sites to assess the development potential further, and agreed to recommend that a report on this exercise should be presented to a future meeting of the Cabinet. However, in so doing, the members of our Sub Group made it clear that we could neither support nor oppose proposals for any *individual* locations, since not only did we not know the sites, we recognised that such a declaration could fetter our individual members' discretion, if such sites were to result in a planning application.

<u>Local Housing Company</u>

2.64 It was reported to us that, at its meeting on 7th September 2009, the Cabinet had considered an initiative promoted by the Leader and Deputy Leader of the Council, and the Housing Portfolio Holder, that could potentially provide a better rate of return for the Council than its current investments (currently less than 1%). Under the proposal, the Council would set up a Local Housing Company to purchase a number of properties on the open market and then let them at market rents, with a loan from the Council. In addition to the Council receiving the loan interest (which would currently amount to around 4%), any surplus rental income (after the deduction of the loan interest and other costs such a legal, management and corporation tax) would also be returned to the Council through a legal agreement. The Directors of the Company would be Council members.

2.65 We noted that initial costings by the Asst. Director of Finance & ICT (Accountancy) suggested that, for every 10 properties purchased and let in this way, the Council could potentially receive additional investment income (currently) of around £57,000 per annum <u>more</u> than from that obtained from normal investments.

2.66 However, we were advised that such an arrangement would be fairly unique and that the Cabinet had therefore agreed to obtain specialist legal advice on, amongst other things:

- How the company would have to be set up
- How the company would operate
- The legal powers available
- The required consents
- Initial tax advice

2.67 In addition, we were advised that it would be necessary to undertake a more detailed financial appraisal of the potential costs and income, and whether the initiative would be financially viable.

2.68 We noted that, once the Cabinet has this information, it would be in a position to make a prudent decision on whether or not to proceed with such an arrangement and, if so, in what way. If the scheme was to go ahead, a decision would also need to be made on the level of loan that should be provided to the Local Housing Company.

2.69 We also noted that, although this initiative would not provide any additional affordable housing, the purchased properties would be let to homeless applicants and other housing applicants on the Council Housing Register, who would normally be unable to access the private rented market, due to the need to fund rent and deposits in advance. Since applicants on low incomes would be eligible to a full or partial local housing allowance (housing benefit), the proposal could assist the same client group as those assisted with the provision of affordable housing.

2.70 We therefore considered it appropriate to draw the Scrutiny Panel's attention to this initiative.

<u>Purchasing Properties off the Open Market</u>

2.71 We were advised by the Director of Housing that the Homes and Communities Agency (HCA) no longer funds housing associations to buy properties off the open market, to let at affordable rents. This is because the HCA's priority is to use its resources to help with new house-building, and the purchase of existing properties does not benefit the house-building industry. However, such an arrangement would increase the amount of affordable housing in the District.

2.72 We noted that the Council has, in the past, provided significant amounts of Local Authority Social Housing Grant to housing associations to provide affordable housing in the District (around £8.1m since 1993). The last scheme to receive LA SHG (£1m) was the development of six former Council-owned sites by Estuary Housing Association, referred to earlier in our report. Generally, the Council has only funded those developments that, for various reasons, cannot be funded by the HCA.

2.73 Therefore, if the Council was willing and able to provide more Local Authority Social Housing Grant in the future, it could provide grants to one of the Council's Preferred RSL Partners to purchase properties off the open market and to let them at affordable rents. We learnt that grant would only be required for part of the cost; the housing association would obtain private finance for the remaining amount.

2.74 We understand that the provision of 2 and/or 3 bedroom houses could assist more people than smaller properties, since existing Council tenants could transfer into larger 2/3 bedroom houses, leaving their smaller accommodation available for other housing applicants. The amount of grant required would vary, depending on the value of the properties, but we were advised that, on average, a grant of £75,000 could be used to purchase a 2 or 3 bedroomed house, especially if the property was previously a Council property, sold under the right to buy.

2.75 After some discussion, we therefore agreed to recommend that budget provision of £375,000 should be made within the Capital Programme, to fund the purchase of around 5 or 6 two or three bedroomed houses within the District. We also agreed to a suggestion by the Director of Housing that a tendering exercise should be undertaken amongst the Council's Preferred RSL Partners to select an RSL that could provide the best value for money.

Prioritisation of Funding Requests to the Council

2.76 Finally, we gave consideration to a suggestion from the Director of Housing that we should prioritise the funding requests that we were proposing. However, we concluded that, because each of the proposals are so different, and would assist either first time buyers and/or housing applicants, it was not possible for us to rank the proposals.

3. New Social House-Building by the Council

Introduction

3.1 We were advised at our meeting that the last new general-needs Council property was built in June 1985 (19 houses built for sale at Mountbatten Court, Buckhurst Hill). Since 1977, the Council has sold around 6,150 properties, predominantly through the Right to Buy. The Council currently owns and manages around 6,500 properties.

3.2 We noted that, since the 1980s, councils have been discouraged by successive governments from building new social housing themselves, and encouraged to act as "enablers", by facilitating housing associations to build new social housing. To discourage councils from building, the Government has previously established financial rules that penalise many local authorities that build – a high proportion of rent received from Council properties has had to be passed on to the Government, in the form of negative housing subsidy (for this Council – around 44%), and 75% of any capital receipts received from the sale of properties under the right to buy has had to be passed to the Government under its pooling arrangements.

3.3 However, we learnt that the Government's policy has now changed. Mainly as a result of the collapse of the property market and the credit crunch, the Government is now encouraging local authorities to build once again. Not only has it removed the main financial disincentives, it has also provided capital funding solely for local authorities to assist with the required capital costs.

3.4 A report from the Director of Housing, circulated with our agenda, provided us with information to consider whether or not the Council should start building new affordable homes again itself, to a modest degree. However, an Addendum Report tabled at our meeting provided us with some important financial information, that seriously affects the viability of the Council undertaking which we refer to later in our report.

New Financial Regulations

3.5 We were noted that Section 80B of the Local Government and Housing Act 1989 enables local authorities to exclude specified properties from the operation of the HRA Subsidy System by agreement with the Secretary of State. In August 2009, following a period of consultation, the Government introduced new regulations, which remove the two major disincentives. These change the revenue and capital rules and allow local authorities to:

- Retain all of the rental income received from new properties (built after August 2009); and

- Retain all of the capital receipts from the sale of properties that were built after the introduction of the changes.

3.6 These rules exclude specific *new* properties from both the HRA subsidy system and the capital rules. This must be done through specific agreements between individual local authorities and the Secretary of State. The types of properties that qualify for exclusions under the proposed scheme are:

- New-build properties

- Properties purchased or otherwise acquired

- Derelict or uninhabitable properties brought back into use as a result of significant council investment

3.7 Local authorities must apply for an exclusion for new developments (or acquisitions) to the Homes and Communities Agency (HCA), who will advise the Secretary of State on whether the exclusion should be allowed.

3.8 Applications must include details about the proposed development, including design and development standards, rents and allocation policies. If agreed, the Secretary of State will issue a short letter of agreement in a standard form.

3.9 Although decisions on how a local authority chooses to invest its own resources is essentially a local matter, in granting an exclusion, we were advised that the Secretary of State would expect to see evidence that "appropriate local decision-making processes have been applied, including a robust options appraisal, and that the chosen option offers value for money". The Government only expects to exclude properties that conform to all Government policies regarding council housing. The Government will also have to consider the overall impact on its fiscal policies when considering applications for exclusion.

Why Develop ?

3.10 Since the development of affordable housing by the Council itself will not increase the overall amount of affordable housing that could otherwise be provided in the District by other agencies (since Council-owned sites could be developed by housing associations), we considered the fundamental question of why develop new affordable housing itself and not simply continue to be, only, an enabler of affordable housing by housing associations - as has been the case since the 1980s ?

3.11 Firstly, we recognised that the Council will continue to be the main facilitator/enabler of affordable housing by housing associations in the District. Most new affordable housing will continue to be developed by housing associations, with the assistance of the Council.

3.12 However, we felt that there are a number of reasons why, in principle, the Council should undertake a modest programme of new social house-building, initially on land in its ownership, provided that the financial circumstances are not inhibitive. Some of our reasons for concluding this are as follows:

(a) Since the late 1970's, with the effects of the Right to Buy, voluntary sales and no new house-building, the Council's housing stock has declined dramatically. Indeed, our housing stock has reduced by around 50% (6,150 homes) since 1977. One of the effects of this decline has been an increase in unit costs. For example, generally, a number of the costs of undertaking a repair/improvement scheme on a housing estate are constant, irrespective of the number of properties involved. An increase in Council properties can therefore reduce unit costs. A similar benefit is obtained in terms of housing management.

(b) The Government's new regulations remove the two main financial barriers that deterred local authorities from building. We therefore have an ideal opportunity to increase the size of our housing stock, without incurring any financial penalties.

(c) The Government/HCA is providing significant funding for councils to build new affordable housing. Although this ring-fenced funding may not continue, it is likely that some form of funding will be available in the future. By accessing this funding, we can increase our asset base and the value of our assets at only a partial cost to the Council.

(d) In the past, the Council has provided significant capital funding and free land to housing associations to provide affordable housing in the District. In the future, the financial benefits of such capital funding and free land would benefit the Council and not housing associations.

(e) We were advised that, generally, financial appraisals expect developments to break even within 30 years. However, the life expectancy of a property is far longer. Therefore, in the long term, we believe that there will be financial benefits to the Council, since rent will still be received beyond 30 years, whilst one of the main costs (loan interest) will no longer be payable. The Council today is now benefitting financially from Council properties built in the late 1970s.

(f) We would have greater control over some of the affordable housing provided in the District (in terms of design and layout).

(g) Although there is no evidence at present, we consider that it is possible that the Audit Commission may, at some time in the future, be critical of the Council for not embracing this Government initiative and the perceived benefits.

Capital Funding Availability

3.13 we noted that, to date, the HCA has held two bidding rounds inviting local authorities (only) to bid for ring-fenced capital funding. Round 1 provided £127m to 47 local authorities to build around 2,000 new council homes – we understand that only 1 local authority is in the East of England (Cambridge), The closing date for Round 2 has passed (30 October 2009) and will provide an additional £180m for new local authority homes. The HCA expects local authorities to provide around 50% of the required capital funding, with the HCA grant funding the remaining 50%. The HCA also expects local authorities to provide the land free of charge.

3.14 Although the Government has not yet announced any further bidding rounds, it is expected that further capital funding will be made available to local authorities in the future, either ring-fenced to only local authorities or, more likely, by allowing local authorities to bid against housing associations for funding from the National Affordable Housing Programme.

3.15 Although the HCA expects to fund local authorities that build on their own land, we believe it is conceivable that, in the future, the HCA could also fund local authority developments on privately owned land, where the land is provided by a developer free, through a Section 106 Agreement (in a similar way to housing associations).

Requirements to Access Funding – The Pre-Qualification Questionnaire (PQQ)

3.16 We were advised that, in order to be able to bid for funding from the HCA, a local authority (or an RSL) must become an "investment partner" of the HCA. To become an investment partner, the applicant must pass a "pre-qualification" process. This involves an application being made to the HCA by the local authority, that must demonstrate that the local authority;

- is of "good standing" (principally through a signed statement of good standing);
- has sufficient technical capacity and experience (through examples of previous development projects); and
- has sufficient financial capacity to handle significant values of grant and has financial viability

Appointment of Development Agent and the Development Process

3.17 When the Council last built Council properties in the 1980s, we had an in-house team with the required skills and experience to undertake the design and to project manage the construction. However, following the effective moratorium on new Council building, these skills and experience have mostly been lost to the Authority. We now only have one Senior Architectural Assistant, who we understand has other commitments and does not have the capacity to undertake even a modest new house-building programme. Moreover, it is unlikely that the Council would pass the PQQ process on its own, since we could not demonstrate that we have either sufficient technical capacity or experience.

3.18 We propose, therefore, that if the Council embarks on a new house-building programme, that we should take a similar approach to smaller housing associations who want to build new social housing – by appointing an existing housing association that is already an investment partner of the HCA to act as Development Agent.

3.19 We understand from the Director of Housing that, in return for a fee (expected to be between 1% - 3% of the works cost), the Development Agent would provide a full development service on behalf of the Council. Initially, we would ask the Development Agent to complete and submit the HCA's Pre-Qualification Questionnaire on behalf of the Council, for us to achieve investment partner status with the HCA. It would then use its existing arrangements and contracts with architects, employers agents and contractors to assist with the development process. We believe that, one of the benefits of this approach, is that we understand most large housing associations already have arrangements with architects, whereby feasibility studies are undertaken by them "at risk". If the development is not viable, or aborted, no fees are payable.

3.20 We would advise that the Council enters into a Development Agreement with the selected Development Agent. We propose that the Development Agent would then, effectively, sub-contract with the required contractors and consultants. The Council would pay the Development Agent for the contractor's and consultants' services under the Development Agreement, which would be in addition to the Development Agency Fee, who would then pass on this payment to the consultants and contractors under their contracts.

3.21 Once a site (or sites) has been identified, we would expect the Development Agent to undertake a Development Appraisal, which would assess whether or not an identified site has development potential, and enable the Council to consider the financial implications, decide whether or not it wishes to proceed, and determine how the development should be funded.

3.22 Following the feasibility stage, we would ask the Development Agent to submit applications to the HCA, on behalf of the Council, to exclude the proposed new Council homes from the operation of the Housing Revenue Account Subsidy System, as explained above.

3.23 Once the application is approved, the Development Agent would then seek planning permission from the Council and capital funding from the HCA on our behalf. Once planning permission and funding approval has been obtained, we would propose that the Development Agent (or its Employers Agent) then selects a contractor and oversee the construction. At practical completion, the newly-constructed homes would be handed over to the Council for letting to applicants on our Housing Register. The properties would be owned by the Council and we would receive the rental income, and manage and maintain the properties.

3.24 We propose that, if the Council agrees to re-commencing a house-building programme, the Development Agent should be appointed following a competitive process. We were advised that, since the total value of the Development Agreement (which would have to include the costs of consultants and contractors) would be in excess of the current EU Procurement Threshold for Services of £139,893, it would be necessary to follow the European OJEU procurement process to appoint the Development Agent. We would strongly suggest that the selected RSL should have to be an existing investment partner of the HCA and we also suggest that they must also have a development base in either Essex or Hertfordshire at the start of the contract. Although we would suggest that the Council's five current Preferred RSL Partners should be allowed to apply, we believe that other RSLs should also be invited to apply.

3.25 In view of the potential number of applicants, we would suggest that interested RSLs should be asked to complete a PQQ, from which a shortlist of four RSLs should be selected using a pre-determined criteria and invited to provide tender submissions. We propose that tenderers should be invited to give presentations to a Selection Panel, and that an appointment should be made on the basis of price and quality, having regard to the RSLs' Tender Submissions and presentations. We would suggest that the Selection Panel comprises the Housing Portfolio Holder, Director of Housing, Asst. Director of Housing (Property) and Asst. Director of Finance and ICT (Accountancy).

3.26 We also suggest that the Development Agreement should be for a three-year period, with an option to extend the Agreement for three further individual years. We would recommend that a review is then undertaken, towards the end of the development period, to enable the Council to decide on the approach we would like to take in respect of future developments, in the light of experience.

3.27 We noted that the Council's own legal service may not have either the expertise or the capacity to draft the required Development Agreement with the Development Agent. If this is the case, we would suggest that we appoint a firm of solicitors specialising in this area to undertake the legal work, although we understand that there is currently no budget. However, since it is expected that this would cost no more than £2,000, we concluded that it could be easily funded by a virement from an under-spent budget, under the delegated authority of officers.

Potential Development Sites

3.28 We understand that the HCA's guidance for the recent bidding rounds makes it clear that the land for any developments must be provided free of charge, and must be for rent (and not for first time buyers – e.g. shared ownership). This suggests to us that only existing Council land can be developed by local authorities. Members of the Housing Scrutiny Panel may be aware that we have been working in partnership with Estuary Housing Association to develop seven former Council-owned sites across the district to provide 41 affordable homes for rent and shared ownership. These have predominantly been former garage sites that were difficult-to-let. We noted that six of these sites have now been completed and that the last site has planning permission and is due to commence shortly.

3.29 We were reminded that the Council has a "Difficult-to-let Garage Policy", which states that any garage sites that have more than 20% of the garages vacant, with no waiting list, should be considered for redevelopment. The Council has many such sites and we were advised that the Director of Housing is currently in the process of filtering out those sites that have no development potential. We understand that, already, it is clear that a number of these are suitable for redevelopment, and could be put through the development process by the Council's Development Agent. Indeed, we were reminded that 7 difficult-to-let Council garage sites have previously been identified as potentially having development potential, following initial feasibility studies undertaken by Home Housing (at the Council's request), and we were advised that these could provide, potentially, 40 new affordable homes, subject to the receipt of planning permission.

3.30 We noted that, more recently, a simple desk-top exercise has identified a further 43 difficult-to-let garage sites, that may also have development potential. We understand that site visits are currently being undertaken to these sites to ascertain whether or not they could be developed.

3.31 Moreover, we understand that the Council has a number of land-holdings held within the General Fund that may become surplus to requirements at some time in the future. We believe that if we have a Development Agent appointed at the appropriate time, any affordable housing required on these sites could be provided by the Council, instead of by a housing association.

3.32 Although not specifically covered by the current bidding guidance, we believe it is possible that some of the affordable housing on large private developments required by Section 106 Agreements could be provided by the Council in future, if the land is provided free. However, we would need to ensure that the Council is not given any advantage over the Council's Preferred RSL Partners, who currently provide most of the affordable housing on such sites, since this could be deemed anti-competitive by both developers and RSLs. In any event, we do not suggest that such developments on

Section 106 sites are considered as part of any Development Agreement, but we may want to consider that as part of our suggested review of the Development Agency approach towards the end of the development period.

Issues and Implications

Proposed HRA Reforms

3.33 Members of the Scrutiny Panel may be aware that the Government has recently consulted on proposed radical changes to the administration of the Housing Revenue Account (to which the Council submitted a response), and is currently considering the responses received from the consultation. One of the Government's proposals is that the national housing debt (amounting to around £15 Billion) is shared amongst all local authorities, including those that (like the Council) are currently debt-free.

3.34 The Asst. Director of Finance and ICT advised us that he has considered whether or not any decision made by the Council to re-commence the building of Council homes would have any effect on the Council's position in the future, as a result of these HRA reforms, and he had concluded that it would have no effect. We were asked to note, however, that if there are any material implications of the Council no longer having its debt-free status as a result of prudentially borrowing (which we refer to later in our report) these implications would arise, in any event, if the Council received a share of the national housing debt as a result of the HRA Reforms.

Use of Capital Receipts

3.35 We considered that another way to fund the Council's contribution would be to utilise capital receipts – either in full or in part. This would have the benefit of avoiding or reducing the amount of prudential borrowing required. However, we acknowledged that such use would have an adverse effect on the Council's General Fund, since the Council would lose the investment interest from those capital receipts, which is currently used to keep council tax to a minimum.

3.36 Therefore, we do not suggest - at this stage - that capital receipts should be used to fund Council-house building. If the Council does decide, at a later stage, to use some capital receipts, this decision would need to form part of the consideration of individual development appraisals (see below).

Development Appraisals

3.37 Once a site has been identified as having development potential, we would expect the Development Agent to undertake a formal Development Appraisal, which would include a financial appraisal. We would propose that all Development Appraisals, at least in the early stages, shoud be reported to the Cabinet for approval. We believe that this is important, since it will be necessary for the Cabinet to not only approve the development, but to also allocate sufficient funding within the Housing Capital Programme and ensure that the proposed development can be adequately resourced through prudential borrowing and/or capital receipts.

Staff Resources

3.38 We acknowledged that the introduction of this initiative would involve staff time being allocated. However, on the advice of the Director of Housing, we believe that this could be undertaken within existing staff resources and would not have any impact on the Council's key housing priorities. We believe that the initiative should be led by the Director of Housing, assisted (particularly in relation to technical issues) by the Asst Director of Housing (Property). We were also advised that the Senior Architectural Assistant, who transferred to the Housing Directorate following the Top Management Restructure, should have some capacity in the near future to also provide support and assistance

Timescales

3.39 In his report to us, the Director of Housing provided us with an indicative timescale of the key milestones. However since, for reasons we explain towards the end of our report, we are not recommending that the Council embarks on a new house-building yet, it is not possible for us to provide a list of key dates. However, we have set out below the estimated timescales for each of key milestones, from the date the Cabinet is in a position to approve our proposed approach, assuming that the OJEU Restricted Procedure is followed:

Approval to proposed approach by Cabinet	Month 0
Updating of Prudential Indicators and Treasury Management Strategy by Cabinet	Month 1
Issue of OJEU Notice	Month 2
Out to Tender to shortlisted RSLs from PQQ process	Month 4
Contract Signed	Month 7
Completion/approval of first feasibilities / development appraisals	Month 10
Receipt of planning permission	Month 14
Start on site	Month 18

Key Risks

3.40 Before making a decision in principle to re-commence a programme of new Council building, we believe that it is very important to consider the key risks, since the costs involved will be large. The main risks that we have identified, based on the Director of Housing's advice, are as follows:

Actual Costs are Higher than Estimated

3.41 We know that the Development Appraisal will assess the construction costs and fees, as well as the estimated rental income, loan interest and ongoing management and maintenance costs. However, although some of these will be relatively accurate, a number of costs/income will be based on assumptions. We believe that the effect of actual costs being different from estimated will vary. Some differences will be negligible, whilst some (for example interest rates) could be significant. We consider that it would be important, therefore, that the Development Appraisals include a "sensitivity analysis", which would explain the effects of differing assumptions, so that the Cabinet can make informed decisions based on different scenarios.

3.42 As always, unexpected site conditions can significantly affect costs – we believe that it will therefore be important to ensure that all developments have financial contingencies.

Abortive Costs

3.43 We know it is possible that some developments, that incur costs up to a particular point, do not proceed. An obvious example is if a development does not obtain planning permission. We believe that these costs can be mitigated to some degree by having arrangements with consultants, whereby the consultants work "at risk" up to the feasibility stage. However, we also know it is possible that some proposed developments do not receive planning permission or that, in the event, the Council decides not to proceed with a development. In these cases, the Council would have to accept that it must bear the abortive costs (in the same way as it is accepted by all developing housing associations), on the basis that such a detriment is outweighed overall by the advantages.

Changes in Government Policy

3.44 We know that Governments often change their position on policies, especially in relation to local government and public housing, and especially when there is a change in Government. However, we believe it is likely that the main effect of a change in approach by Government would simply be that the Council would no longer be able to continue developing itself. The only financial effect would be the set-up costs, which will be minimal – mainly officer time.

3.45 We feel some comfort can be taken from the fact that we were advised that the Conservative Shadow Housing Minister has recently been reported as saying that a Conservative Government would introduce incentives for those local authorities that built homes – they would be able to keep the council tax generated by those homes. We were also advised that the Liberal Democrat Shadow Housing Minister was reported as saying, at the same event, that the priority of a Liberal Democrat Government would be to make sure local authorities are able to borrow and build (new homes) quickly.

3.46 We believe that the main risk is if policy changes by the Government or the Tenant Services Authority (TSA – the body that has taken over the regulatory functions for social housing from the former Housing Corporation) have an effect on properties already developed. For example, we understand that the TSA has policies relating to levels of rent increases by housing associations, linked to the Retail Prices Index – which is currently very low. We were advised that this has resulted in some housing associations experiencing financial difficulties, since their rental income is lower than provided within their business plans. We identified that such a situation could have an effect on the Council in the future, if we developed our own housing again. However, we concluded that it is unlikely that any Government, or the TSA, will implement policy changes that have a catastrophic effect on the majority of social housing providers. In any event, we took comfort from the fact that the Council would have a number of options available to deal with such circumstances, including the sale of vacant properties.

<u>Poor Performance by, or Disputes with, the Development Agent</u>

3.47 We believe that the performance of the Development Agent will be key in this process. It will also be important that the Council has a good working relationship with the Development Agent. Poor performance could cause problems for the Council in future years. Inaccurate development appraisals could result in financial implications for the Council.

3.48 We concluded that the most appropriate way to mitigate such situations is two-fold. Firstly, we feel it is important to ensure a robust selection process. We would suggest that this should involve a filtering of housing association applicants, to ensure that only housing associations that have a good track record in development and a demonstrable capacity of skilled staff are shortlisted for detailed consideration. We would recommend that shortlisted applicants should be required to provide a detailed tender submission setting out their experience, track record and proposed approach - and to give a presentation to the proposed Selection Panel and answer questions. We would recommend that the capabilities of the shortlisted applicants should also be discussed with the HCA and TSA, both of whom we understand regularly monitor - and publicly report on - the effectiveness of housing associations' development functions.

3.49 Secondly, we know that development appraisals submitted by the Development Agent will be scrutinised by Housing and Finance staff, as well as the Corporate Executive Forum (CEF – comprising the Chief Executive and Deputy Chief Executive) prior to their submission to the Cabinet for approval.

3.50 In anticipation of the potential for a dispute arising between the Council and the Development Agent, we feel it important to ensure that the Development Agreement between the two parties sets out clear arrangements for dealing with disputes, including mediation and/or arbitration. Moreover, we would recommend that the Development Agreement should have an appropriate mechanism to ensure that the Council can terminate the contract with the Development Agent in the event of poor performance.

<u>Poor Performance by, or Disputes with, the Consultants or Contractor</u>

3.51 We anticipate that the building contractor and consultants would be appointed by the

Development Agent, who would either enter into - or already have - formal contracts with them. Any poor performance by, or disputes with, the consultants or contractor would therefore be matters for the Development Agent to resolve. However, we recognised that such poor performance or disputes could have an effect on the Council, since it would be us that would have to meet any additional building costs or fees, and who would own the properties once built. There could potentially be a problem for the Council, due to the Council having no contractual right to resolve concerns with the consultants or contractor direct, after the properties have been handed-over to the Council; they would have to be taken up by the Development Agent on the Council's behalf. However, we noted that this risk could be mitigated - by requiring the consultants and contractor to provide collateral warranties to the Council, which would give us the legal power to directly require the consultants or contractor to resolve any problems, in accordance with their contracts with the Development Agent.

<u>Contractor Insolvency</u>

3.52 One of the Development Agent's responsibilities will be to appoint the contractor to undertake the construction. In the event of the contractor becoming insolvent, we recognised that the Council would have to deal with the resultant fall-out, including the likely incurring of additional costs. However, we consider that this is no different to the existing risk that the Council experiences when it appoints contractors to undertake any Council development or service. Indeed, arguably – apart from the financial effects – we feel that the implications could be less severe than for major improvement projects on, say, tenanted properties, since the inevitable delays that result from an insolvency can have a major detrimental effect on local residents.

3.53 We concluded that the best way to mitigate such effects would be to ensure that the Development Agent has robust arrangements in place for appointing contractors, including the effective assessment of the contractor's finances and financial capacity.

<u>Prudential Borrowing – A Financial Problem</u>

3.54 We were advised that, under the current funding available from the HCA, there is an expectation that 50% of the required funding will be provided by the HCA in the form of capital social housing grant. The remaining 50% is expected to be provided through a loan taken out by the local authority. We noted that a number of years ago, local authorities could only borrow up to a specified amount approved by the Government. However, local authorities can now adopt an approach called "prudential borrowing".

3.55 We learnt that, under current prudential borrowing rules, the Council is allowed to borrow for capital purposes on the basis that it is able to make the interest payments from its ongoing revenue budget. The Asst. Director of Finance advised us that, in the case of building council homes, it would need to be demonstrated that in the 'long term' (usually assumed be to 30 years for illustrative purposes) the interest and principal repayments on the loan could be financed from the surplus of rental income over expenditure, including major repairs. Clearly, this depends heavily on the interest rate and the level of rent that could be charged, given that the rent would need to be at an affordable level.

3.56 However, we studied an important Addendum Report tabled at our meeting from the Asst. Director of Finance, which reported on the outcome of his investigations into the financial implications of the Council re-commencing new house-building, following advice he had received from the Council's financial advisers, Butlers. The financial issues are very complex, so were grateful that the Assistant Director of Finance was in attendance at our meeting to explain in more detail and answer our questions.

3.57 His Addendum Report explained that it needs to be borne in mind that only the Council as a legal entity can borrow money, and that the Housing Revenue Account (HRA) cannot in itself 'borrow'. Therefore, if the Council makes such a decision, then the cost of borrowing initially falls on the General

Fund and is then recharged to the HRA on a prescribed basis.

3.58 We learnt that the prescribed basis for recharging the cost of borrowing refers to what is called the Capital Financing Requirement (CFR). The CFR is defined as a measure of the Council's need to borrow to finance capital expenditure. The CFR is split between a General Fund (GF) CFR and a Housing Revenue Account (HRA) CFR. We were advised that the overall CFR is currently negative £784,000 - which means that, overall, the Council has no need to borrow to fund our existing Capital Programme. However we can still choose to borrow, as long it is 'affordable' in the long term.

3.59 For our Council, the split of the CFR is that the HRA CFR is negative £22,803,000, and the GF CFR is positive £22,019,000. We were advised that the HRA CFR is negative because, prior to the requirement to pool HRA receipts from Right to Buy sales, the Council had - by law - to "set aside" 75% of these receipts to repay debt. This was because, at that time, the Council was not debt free. This means that, effectively, the GF has used HRA capital resources to finance capital expenditure and 'borrowed' from the HRA, without cost.

3.60 We were advised by the Asst. Director of Finance that, if the Council borrows £2m and uses this to build houses, the effect would be to increase the overall CFR by £2m - to £1,216,000 (i.e. £2m minus £0.784 m). This would be made up of the HRA CFR being negative £20,803,000 and the GF CFR being positive £22,019,000. Therefore, the HRA would still have no need to borrow; all that would have happened is that the GF would have replaced a loan from the HRA with a loan from an external source.

3.61 The cost of the loan would therefore be a charge, initially, to the GF - but there would be an assumption that this would then be recharged to the HRA, based on its CFR. However, the HRA would be negative. Therefore, there would be no basis to recharge the HRA, since it would have no underlying need to borrow. Consequently, the total cost (i.e. the interest and principal) would fall on the GF. This would mean that both the interest (currently estimated at 4.3%) <u>and</u> the Minimum Revenue Provision (MRP - a sum that would have to be set aside from revenue budgets to pay off the loan principal), estimated at 2%, would fall on the GF.

3.62 We noted that interest is charged to the GF at the Consolidated Rate of Interest (CRI), which is the <u>average</u> rate of interest payable on the money borrowed. Since there would only be one loan of (say) £2m - this CRI would also be (currently) 4.3%. If other loans were subsequently taken out, the CRI would move up or down, depending on the rates and terms of those loans. Crucially, the HRA would only contribute to the borrowing costs, once its own CFR becomes positive. i.e. if over £22.803m is borrowed.

3.63 On a slightly separate issue, we noted that the Council receives investment interest from our unused capital receipts and other unused cash, although the rate is currently very low (under 1%), and that the allocation of income between the GF and HRA has to be based on the CFR. This applies regardless of whether the Council has debt or not.

3.64 We were advised, therefore, that if we borrowed, say, £2m to finance new house-building, the HRA would lose some of the interest income from the Council's investments and that the GF would gain investment income. This is because the allocation of investment income would be based on an HRA CFR of £20.803m, multiplied by the CRI - rather than an HRA CFR of £22.803m.

3.65 However, we were advised that, overall, any proposal to build Council houses at present would be detrimental to the GF. If the Council borrowed £2m to fund, say 40 properties, it would cost the GF an amount estimated at £106,000 per annum (£2m X 6.3% = £126,000) – (£2m X 1% = £20,000 lost investment interest). If £4m was borrowed for the construction of, say, 40 properties, it would cost the GF around £212,000 per annum.

3.66 However, if at some point in the future, investment interest rates exceed the Consolidated Rate of Interest plus the MRP, then the GF would gain. We noted, though, that the likelihood of this is somewhat slim and, again, would only be temporary until interest rates again.

3.67 In simple terms, although the Housing Revenue Account would receive the rental income from any properties that the Council builds, the cost of the loan would have to be borne by the General Fund, which we feel at the current time makes any proposal to recommence a programme of Council house-building financially unviable for the General Fund.

3.68 In passing, we noted that if the Council does adopt the use of prudential borrowing at some time in the future, it would be necessary for the Council to review its Prudential Indicators and Treasury Management Strategy before any development appraisals could be considered.

Views of the Tenants and Leaseholders Federation

3.69 We were advised that, at its meeting held on 24th November 2009, the Tenants and Federation considered the same report from the Director of Housing on New Social House-building by the Council as us. They also had the benefit of the financial information provided by the Assistant Director of Finance. The Addendum Report to our meeting set out the Federation's recommendations to us.

4. Conclusions

4.1 After detailed discussion of all the issues involved, we reached the same conclusions as the Federation (which it had asked the Sub Group to take into account). We therefore agreed that the Federation's recommendations should form the basis of our recommendations to the Housing Scrutiny Panel.

5. The Sub-Groups Recommendations to the Housing Scrutiny Panel

5.1 Having considered all of the issues, we would recommend to the Housing Scrutiny Panel that it reports on to the Cabinet with the following recommendations:

On increasing the amount of affordable housing:

(1) That the £350,000 budget provision already agreed by the Cabinet to invest in an Open Market Shared Ownership Scheme be retained within the Capital Programme;

(2) That the Director of Housing contacts other Homebuy agents to discuss the possibility of an existing Homebuy Agent working with the Council to operate either:-

(a) the scheme previously proposed in partnership with Moat Housing, already agreed by the Cabinet; or

(b) an alternate scheme, similar to the Government's MyChoice Homebuy Scheme, but with the Council undertaking the role of the Homes and Communities Agency; and

(c) that a further report be provided to the Cabinet setting out the outcome of discussions with the Homebuy Agents;

(3) That the Home Ownership Grant Scheme be continued into 2010/11, to fund a further six Home Ownership Grants of £28,000 each (instead of the current amount of £34,000 each) and;

(a) That budget provision of £170,000 be made within the Capital Programme for 2010/11;

(b) That the existing Selection Criteria for applicants previously agreed by the Housing Portfolio Holder continues to be used; and

(c) That, in the first instance, all those unsuccessful applicants for the Home Ownership Grant Scheme in 2009/10 be contacted, to see if they are still interested in receiving a grant;

(4) That, once the desk-top exercise has been completed to assess the development potential of difficult-to-let garage sites with vacancies in excess of 20% (and no waiting list), more detailed development appraisals be undertaken to assess their development potential further – and the number of homes that could be provided;

(5) That a report on the outcome of these development appraisals be presented to a future meeting of the Cabinet, with a view to authorising that planning permission be sought for each of the sites so that those sites obtaining planning permission could be developed to provide additional affordable housing;

(6) That the current position with the proposal of the Cabinet that the Council sets up a Local Housing Company - to which it would provide loans for the Company to purchase properties on the open market to let at market rents, (subject to the properties being let to nominees of the Council on the Housing Register) - be noted;

(7) That budget provision of £375,000 be made within the Capital Programme for 2010/11 to fund the provision of Local Authority Social Housing Grant to one of the Council's Preferred RSL Partners to fund the purchase of 5/7 two and/or three bedroomed houses off the open market to let at affordable rents;

(8) That the Preferred RSL Partner to purchase these open market properties be selected through a competitive tendering exercise; and

(9) That the proposals above requiring capital budget provision be not prioritised in a ranked order.

On undertaking a programme of new social house-building:

(10) That, subject to (11) below, in principle, the Council should recommence a programme of new social house-building;

(11) However, in view of the financial difficulties such a programme would currently have on the Council's General Fund, such a programme should not be undertaken until the detrimental financial effect on the Council's General Fund either no longer exists or is only minimal; and

(12) That the Council should explain this financial difficulty to both the Government's Minister of State for Housing and the Local Government Association (LGA) to ask them if, in view of the Government's previous commitment to remove any obstacles that stop councils from building new Council homes, the Government and the LGA could assist to overcome the problem relating to the Council's Capital Financing Requirement.